

MARKET CONDUCT EXAMINATION REPORT

OF

LEXINGTON INSURANCE COMPANY

AS OF

September 1, 2006

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of SEPTEMBER 1, 2006 of the

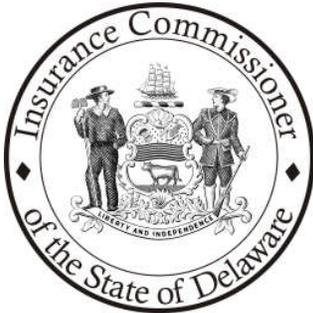
LEXINGTON INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Handy

DATE: 15 JULY 2008

In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 15TH DAY OF JULY 2008.



Matthew Denn
Insurance Commissioner

REPORT ON MARKET CONDUCT EXAMINATION
OF THE
LEXINGTON INSURANCE COMPANY
AS OF
SEPTEMBER 1, 2006

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 15TH day of JULY, 2008.

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SALUTATION

January 17, 2008

Honorable Matthew Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner Denn:

In compliance with the instructions contained in Certificate of Examination Authority Number 05.777, and pursuant to statutory provisions including 18 Del. C. §318-322, a Market Conduct Examination has been conducted of the affairs and practices of:

Lexington Insurance Company.

The examination was performed as of September 1, 2006. Lexington Insurance Company, hereinafter referred to as "Company" or as "Lexington," is incorporated under the laws of the State of Delaware. This examination consists of two phases, an on-site phase and an off-site phase. The on-site phase of the examination was conducted at the following location:

100 Summer St. Boston, MA 02110.

The off-site examination phase was performed at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or as "DDOI" and other appropriate locations.

The report of examination thereon is respectfully submitted.

EXECUTIVE SUMMARY

Lexington Insurance Company was incorporated on March 31, 1965 under the laws of the State of Delaware. Its main administrative office is located at 100 Summer St. Boston, MA 02110.

As a Surplus Lines writer the Company focuses on insuring risks for which admitted writers cannot provide the insurance coverage, either because of the complexity of the risk or because the coverage does not lend itself to conventional insurance contracts.

This examination is a Delaware Baseline Examination in which the processes, procedures and controls utilized by the Company in its various business areas are reviewed and evaluated. The following business areas were reviewed: Company Operations/Management, Complaint Handling, Marketing and Sales, Producer Licensing, Policyholder Service, Underwriting and Claims Handling.

One area of concern was noted during the examination. The concern in Procedure 11, Complaint Handling, is with the Company's lack of follow-up on complaints pertaining to Independent Adjustors. See section C.2 for additional information regarding this issue.

SCOPE OF EXAMINATION

While the basic business areas that are subject to a Delaware Market Conduct Examination vary depending on the type of insurer, all baseline examinations include, Company Operations/Management, Complaint Handling, Marketing and Sales, Producer Licensing, Policyholder Service, Underwriting & Rating and Claims.

This examination is comprised of two components. The first is a review of the Company's countrywide complaint patterns. This review is not a pass/fail test, rather, it determines whether or not there is a detectable pattern to the complaints the Company receives from all sources.

The second component is an analysis of the management of the various business areas subject to a Market Conduct Examination through a review of the written procedures and operating processes of the Company. This component also includes an analysis of how the Company communicates its instructions and intentions to its operational echelons, how it measures and monitors the results of those communications, and how it reacts to and modifies its communications based on the resulting findings of the measurement and monitoring activities. The examiners also determine whether or not this process is dynamic and results in enhanced compliance activities. Because of the predictive value of this form of analysis, focus can be directed on those areas where review indicators suggest that the process used by management does not appear to be achieving the appropriate levels of statutory and regulatory compliance.

All business areas noted above are addressed, to some extent, by one or more of the Procedures reviewed, thus providing a comprehensive view of the Company and its component operations.

This examination report is a report by exception rather than a report by test. This means that only those areas where a Recommendation for corrective action is made are detailed in this report.

HISTORY AND PROFILE

Lexington Insurance Company was incorporated on March 31, 1965 under the laws of the State of Delaware and began business on April 1, 1965. The Company commenced business by assuming substantially all of the in-force business of the First State Insurance Company, also a Delaware corporation. At the time of incorporation, the Company was 100% owned by AIG, a Delaware holding company. On December 31, 1985, AIG transferred its ownership of the Company as follows: 70% to National Union Fire Insurance Company of Pittsburgh, PA, 20% to The Insurance Company of the State of Pennsylvania, and 10% to Birmingham Fire Insurance Company of Pennsylvania (now known as AIG Casualty Company), all of whom are member companies of AIG.

The Company writes substantially all Property and Casualty lines of business with a focus on Commercial business. The Company writes all classes of business insurance, including large commercial or industrial property insurance, excess liability, medical malpractice, inland marine, environmental, and excess and umbrella coverages. In addition, the Company also offers many specialized forms of insurance such as equipment breakdown, directors and officers' liability, difference in conditions, and various types of errors and omissions coverages. As a surplus lines insurer, the Company accepts business from licensed surplus lines brokers. The Company also serves as the lead participant in an inter-company pooling arrangement that is comprised of the Company and two affiliated companies, Landmark Insurance Company and AIG Excess Liability Insurance Company, Ltd. (formerly known as Starr Excess Liability Insurance Company, Ltd.).

METHODOLOGY

This examination is based on the Standards and Tests for a Market Conduct Examination of a Property & Casualty Insurer found in Chapter VIII of the Delaware Market Conduct Examiners' Handbook. This chapter is derived from applicable Delaware Statutes, Rules and Regulations as referenced herein and the NAIC's *Market Conduct Examiners' Handbook* (2004 edition).

The types of review used in this examination fall into three general categories: generic, sample, and electronic.

A "generic" review is conducted through an analysis of general data gathered by the examiner or provided by the examinee in response to queries by the examiner.

A "sample" review is conducted through direct review of a random sample of files using a sampling methodology described in the Delaware Market Conduct Examiners' Handbook and the NAIC's *Market Conduct Examiners' Handbook*. Samples of complaint files, underwriting files and claim files were reviewed to determine that the processes described by the Company are actually used by the Company.

An "electronic" review is conducted through the use of a computer program or routine applied to a download of computer records of the examinee. This type of review typically reviews one hundred percent (100%) of the records of a particular type.

In this examination only two Standards were directly tested. The Procedures were tested through a combination of “generic” review and direct observation of the processes used. Each Standard contains a brief description of the purpose or reason for the Standard. The Procedure review does not include this description. The examiners’ “Observations” are noted following both Standards and each Procedure where a “Recommendation” for corrective action is made.

A. COMPANY OPERATIONS/MANAGEMENT

This examination report is not designed to be a pass/fail report except for the following two Standards dealing with appropriate licensure and cooperation with the examination process.

Standard A 08

NAIC’s *Market Conduct Examiners’ Handbook - Chapter VIII, §A, Standard 8*
The Company is licensed for the lines of business that are being written.
18 Del. C. §318(a), §505(b), §508(b)

The review methodology for this Standard is “generic.” This Standard has a direct insurance statutory requirement. This Standard determines whether or not the Company’s operations are in conformance with the Company’s Certificate of Authority.

Results: Pass

Observations: The Company is licensed for the lines of business being written based upon a review of premium schedules and the Company’s Delaware Certificate of Authority.

Recommendation: None

Standard A 09

NAIC’s *Market Conduct Examiners’ Handbook - Chapter VIII, §A, Standard 9*
The Company cooperates on a timely basis with the examiners performing the examination.
18 Del. C. §318(a), §320(c), §508(b), §520(b)3

The review methodology for this Standard is “generic.” This Standard has a direct insurance statutory requirement. This Standard determines whether the Company is cooperating with the examiners in the completion of an open and cogent review of the Company’s operations. Cooperation with the examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely manner thereby minimizing cost.

Results: Pass

Observations: The Company cooperated with the examiners in the conduct of the examination. All persons involved with the examination were cooperative and provided all requested information on a timely basis.

Recommendation: None

B. COMPLAINTS

The evaluation of the Standards in this business area is based on the Company's response to various information requests (IRs) and their handling of complaint files at the Company. Delaware statute 18 Del. C. §2304(17) requires the Company to "...maintain a complete record of all complaints received." This statute also requires that "this record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint." Delaware's definition of a complaint is: "... any written communication primarily expressing a grievance."

Observations: Based upon the examiners' review it appears that the Company maintains a complete and accurate Complaint Log. This was further confirmed during the review of the Company's claim and underwriting files wherein no additional complaints were found in these files.

The Company's Complaint Log listed 175 nationwide complaints received during the examination period. Of these 175 complaints a sample of fifty (50) files were selected for review. Of the fifty (50) files reviewed, five (5) were found to have errors, all of which pertained to complaints against independent adjustors used by Lexington. Refer to the discussion below pertaining to Procedure 11 – Complaint Handling.

C. REVIEW OF PROCEDURES

The management of well-run companies generally has some processes that are similar in structure. These processes usually take the form of written procedures. While these procedures vary in effectiveness from company to company, the absence of these procedures or the ineffective application of them is often reflected in the failure of various examination Standards. The processes usually include:

- a planning function where direction, policy, objectives and goals are formulated
- an execution or implementation of the planning function elements
- a measurement function that considers the results of the planning and execution, and
- a reaction function that utilizes the results of measurement to take corrective action or to modify the process to develop more efficient and effective management of its operations.

The absence of written procedures that provide direction for company staff in its various operational areas tends to produce an inconsistent application of the intended process. The same is generally true of the absence of a means to measure the results of the application of procedures and a means to determine that the process is performing as intended.

The reviews in this section are not pass/fail measurements. Rather, they are intended to reflect those management strengths and weaknesses that have a bearing on regulatory compliance issues.

The following list itemizes all Procedures that were reviewed, but for which no concerns or recommendations were noted. Subsequent to this listing is a detailed explanation of the aforementioned Recommendation made for Procedure 11 – Complaint Handling.

C.1. Procedures Reviewed but with No Recommendations

Procedure 01 – Audit (Internal and External)
Procedure 02 – Assertion of Privilege
Procedure 05 – Anti-Fraud
Procedure 07 – Managing General Agent (MGA) Oversight and Control
Procedure 08 – Vendor Oversight and Control
Procedure 09 – Customer and Consumer Privacy Protection
Procedure 10 – Production of Business
Procedure 13 – Advertising, Sales and Marketing
Procedure 14 – Agent Produced Advertising
Procedure 20 – Producer Selection, Appointment and Termination
Procedure 21 – Producer Defalcation
Procedure 22 – Prevention of the Use of Persons with a Felony Conviction
Procedure 24 – Premium Billing
Procedure 26 – Policy Issuance
Procedure 28 – Requesting Claim History
Procedure 30 – Premium Determination and Quotation
Procedure 32 – Underwriting and Selection
Procedure 34 – Terminations
Procedure 35 – Underwriting File Documentation
Procedure 40 – Staff Training
Procedure 43 – Claim Handling
Procedure 44 – Internal Claim Audit
Procedure 45 – Claim File Documentation
Procedure 48 – Catastrophic Claim Handling

C.2. Procedures Reviewed with a Recommendation

Procedure 11 – Complaint Handling

The Company's handling of the investigation of complaints concerning independent adjusters was not adequately documented. In the review of the complaints, there were five (5) exceptions noted, all related to this same issue. Although the Company resolved all of the other aspects of the complaints, these five (5) files did not contain evidence of the Company's investigation into the allegations pertaining to the Independent Adjustors. Without specific documentation it is not clear that the Company actually investigated the allegations.

The Company stated that it is standard procedure for the Legal Department to notify the Claims Department of all complaints received, including those involving independent adjusters. The Claims Department is then supposed to investigate the allegations and resolve any outstanding issues. The Company's written Complaint Handling Procedure does state that all parties cited in the complaint are to be investigated. However, there is no specific language in the Company's Procedures addressing complaints made against an Independent Adjustor, the requirements for that complaint investigation and the documentation needed for that investigation.

An Independent Adjustor does not have the same relationship with the Company as an agent or an employee. While the Company's current procedures require all parties cited in a complaint to be investigated, it is not clear that this requirement applies to Independent Adjustors.

Adjustors are generally used to evaluate the merits of a claim and to make recommendations to the company regarding the benefits that might be payable for the claim. An Independent Adjustor is an independent contractor who adjusts claims for different insurance companies on an as-needed basis. Companies whose financial resources or volume of claims may not require employing their own in-house adjustors generally use the services of an Independent Adjustor.

Since there was no evidence in the complaint files that the Company investigated the five (5) complaints received pertaining to the Independent Adjustors, then either the Company's personnel did not know to, or simply did not, follow-up on these allegations.

Given the nature of the allegations in these complaints [*i.e.*, lack of punctuality, lack of communication, rudeness, lack of knowledge of claim handling standards, excessive time delays, and lack of claim file documentation] the Company should communicate its own Claim Handling Standards and expectations to all Independent Adjustors it contracts with to ensure that all claims are handled properly.

Recommendation: It is recommended that the Company add specific instructions to its Complaint Handling Procedures stating that any complaints pertaining to an Independent Adjustor be handled in the same manner as any other complaint. It is recommended that these instructions also address the Company's Claim Handling Standards and Investigation Standards. Finally, it is recommended that the Company communicate its own Claim Handling Standards and expectations to all Independent Adjustors with which it contracts.

CONCLUSION

The examination was conducted by Brian Tinsley, Sean Connolly, Nobu Koch and Cynthia Amann and is respectfully submitted.



Brian Tinsley
Market Conduct Examiner-in-Charge
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State of Delaware



Cynthia M Amann
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